The Undercover Economist Strikes Back: How to Run or Ruin an Economy

By Tim Harford

(Reviewed by Cel Kulasekaran)

Tim Harford needs very little introduction, Javier Estrada has done Harford justice in his review of Harford's first book (JOIM Q2, 2006) - *The Undercover Economist*, which delivers microeconomics to the masses. This sequel is a complementary treatment on macroeconomics. Harford promises to shed light on what is happening to the world economy, why we should care, and what we can do to do better.

The book starts (and ends) with the use of Bill Phillip's Monetary National Income Analogue Computer (MONIAC) at the London School of Economics in the post-depression years to resolve macroeconomic problems in the UK. Harford uses this example to excite us and to demonstrate the resolve and creativity needed to manage any economy. *The Undercover Economist Strikes Back* engages the reader in a dialogue mode, with the reader assuming responsibility for the world economy. The conversation begins by disclosing that economists do not understand everything about how to prevent economy's growth slowing or when/how it goes into reverse.

Harford next introduces the concept of printing money and price stickiness (or rigidity) using the Capitol Hill Babysitting Cooperative (popularized by Paul Krugman's *Peddling Prosperity*) as an example. The Cooperative's problems are well discussed. Real world problems are more complex and messy. This example illustrates clearly that economies can get into a rut.

The dialogue segues into monetary systems and the introduction of the gold standard. Harford uses Brazil as a good contemporary discussion of hyperinflation and solution, which was not addressed in the previous chapter. Harford continues to build using the Babysitting example on the importance of inflation in the next chapter, "Just Enough Inflation"; the discussion of deflation/inflation effects and causes of hyperinflation is detailed.

The conversation with Harford continues to formalize the idea of stimulus, as he guides us through the Keynesian strategy of spending to lift out of recessions. What follows is a discussion on the controversy over the International Monetary Fund's multiplier effect estimates following the crisis.

To distinguish between fiscal and monetary stimulus, Harford examines Robert Radford's "*The Economic Organisation of a P.O.W. Camp*". Radford's publication describes a prison camp recession due to failure of Red Cross supply, which we can contrast against the Babysitting recession due to failure of demand. Exogenous shocks (mobile phones, China's growth, natural disasters like the Tōhoku earthquake, and oil crises) change potential output and supply. Both Keynesian and Classical perspectives can be used depending on circumstances, that is whether problems are demand or supply induced.

The next dialogue discusses Potential Output and how estimations of it depend on trend, unemployment levels, surveys, and inflation. Harford seems to suggest that conservatives trim spending during booms and liberals spend during recessions.

Harford next introduces cyclical and structural unemployment using Henry Ford's implementation of "efficiency wages" and an evaluation of the recent Mediterranean / Euro crisis. The discussion does not consider that structural unemployment could be due to deep seated uncompetitiveness of an economy. He acknowledges that the current Mediterranean employment model provides little help to the young unemployed and overprotects permanent employees.

In a Boss-onomics chapter, Harford deliberates with the reader whether performance within industry varies according to management quality. Advanced economies (America, Japan, Germany, UK, Australia) have better management than developing countries (China, India, Brazil). This discussion is relevant to competitiveness of the respective economies. Harford seems to judge America leading in management on some criteria which may be true, but may not be comprehensive enough. An examination to square with the greater success and productivity of Japanese firms vs. American (Honda vs. GM) could be an interesting inclusion to the text.

The final chapters of the book discuss the misuse of the Phillips curve (unemployment vs. money wage changes), GNP, and Happynomics. Finally, Harford reviews growth and inequality. The dialogue describes the implications of zero-growth model on debt and inequality.

Harford concludes with a discussion on the future of macroeconomics. Academics know that forecasts of complex systems are difficult and the most exciting (economics) innovations come from microeconomics – market design and auctions. Harford reveals that macroeconomics fails to incorporate new perspectives in banking, behavioral economics and complexity theory. He argues that insights about actual human behavior (sticky prices, efficient wages, game theoretic expectations) having no relevance to the economy is incoherent.

The book posits a zero-growth model as normal, which is a welcome respite from all the high growth expectations that drives our economies and lives. Complexity science has also punctured basis for confident forecasts. Over confidence and high growth expectations can cause problems. If we don't commit to strong growth expectations, perhaps problems will disappear. Harford uses the story of (Bill) Phillips curve fame as an interesting and realistic framework for the book, the origins of macroeconomics, its progress and development over the decades. Phillip's focus on practical models of the economy is maintained. Problems with debt, stickiness, poverty, and inequity are disclosed objectively to make the book a realistic one. Good, well-written, objective introduction to contemporary macroeconomics. *The Undercover Economist Strikes Back* should be this weekend's read.